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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1960.

No. 42.

SMALL BUSINESS ADMINISTRATION,
Petitioner,

vs.

G. M. McCLELLAN, Trustee,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS, TENTH CIRCUIT.

BRIEF FOR RESPONDENT.

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OPINIONS BELOW.

This proceeding originated in bankruptcy in the United States District Court for the District of Kansas. The first decision was made by the Honorable E. R. Sloan, Referee in Bankruptcy. That opinion is unreported, but is contained in the record at pages 33 through 36. The opinion of the United States District Court for the District of Kansas, on petition for review, is reported at 168 F. Supp.

483, and appears in the record at pages 38 through 43. The opinion of the United States Court of Appeals for the Tenth Circuit is reported in 272 F.2d 143, and appears in the record at pages 45 through 49.

JURISDICTION.

The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1). The jurisdictional requisites are set forth in the brief of petitioner.

STATUTES INVOLVED.

The statutes involved are:

1. Section 64, Fifth, 11 U.S.C. §104(5) of the Bankruptcy Act which provides:

> "(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority * * *."

2. R.S. §3466 (31 U.S.C. §191) which provides:

> "Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

QUESTIONS PRESENTED.

The question for determination is whether or not the Small Business Administration, under the facts of this case, and the Small Business Act of 1953, is entitled to priority as to 75% of the unpaid portion of a note executed by a bankrupt to the Brookville State Bank. This raises the following subsidiary questions:

1. Whether or not the allowance of the priority would be inconsistent with other statutes and acts of Congress.

2. Whether or not there was a debt due to the Small Business Administration or the United States at the date of bankruptcy.

3. Whether or not debts due to the Small Business Administration are "debts due to the United States" within the meaning of R.S. §3466.

STATEMENT.

This is a proceeding to establish a claim on behalf of the Small Business Administration against a bankrupt, and to determine the priority status, if any, of the claim.

The facts are not in dispute.

On November 19, 1956, a participation agreement was entered into between the Small Business Administration and the Brookville State Bank, Brookville, Kansas. (Exhibit A, R. 4-9). This agreement recites that S. H. Byquist, d/b/a Western Distributors, "has made application for a loan in the amount of $20,000.00" and "S.B.A. desires to purchase a participation of 75% of the loan or such part thereof as bank may disburse to borrower." (Exhibit A, R. 4)

By the participation agreement, the Small Business Administration agreed that upon written demand by the bank, it would purchase from the bank a participation of 75% of each disbursement made by the bank. (Exhibit A, ¶ 2, R. 4). It was further agreed that the bank and S.B.A. would share ratably in accordance with their respective interests in the loan any income, expenses, or losses. (Exhibit A, ¶¶ 12, 13, 14, R. 8-9).

The Brookville State Bank did lend to S. H. Byquist, d/b/a Western Distributors, $20,000.00, evidenced by a promissory note dated November 16, 1956, payable to the order of the Brookville State Bank, Brookville, Kansas. (Exhibit B, R. 9-13). The bank, pursuant to the provisions of paragraph 2 of the participation agreement, made written demand on S.B.A. for purchase of 75% of the disbursement. (Exhibit F, R. 27). Pursuant to the participation agreement and this demand, S.B.A. sent a check for $15,000.00, dated November 23, 1956, to the bank (Exhibit C, R. 15), for purchase of its participation in the loan to Byquist.

On September 5, 1957, S. H. Byquist, an individual, d/b/a Western Distributors, was adjudicated a bankrupt. (R. 32).

Subsequent to the institution of the bankruptcy proceedings and the adjudication in bankruptcy, the Brookville State Bank assigned the note to Small Business Administration. (R. 32).

On October 15, 1957, Small Business Administration duly filed a proof of claim in bankruptcy for the full unpaid balance of the note. (R. 2-3).

On November 22, 1957, after all due credits were given there remained due on said note the sum of $16,355.69, with interest paid to the date of bankruptcy. (R. 32).

The total gross estate in the hands of the trustee is approximately $19,000.00, against which claims totaling $43,682.07 have been filed. (R. 32).

The trustee duly filed objection to the allowance of the S.B.A. claim as a priority claim on the grounds that S.B.A. was created as a separate entity and was not invested with the sovereign privileges and immunities of the United States (*Sloan Shipyards Corporation* v. *United States Shipping Board*, 258 U.S. 549, 66 L. Ed. 762; *RFC* v. *J. H. Menihan Corp.*, 312 U.S. 81, 85 L. Ed. 595; *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23); that the assignment of this claim occurred after the date of bankruptcy, or insolvency and no debt was due to the Small Business Administration at the date of bankruptcy (*United States* v. *Marxen*, 307 U.S. 200, 8. L. Ed. 1222); that the allowance of the priority would be inconsistent with the Small Business Act of 1953 and other statutes and acts of Congress (*United States* v. *Guaranty Trust Company*, 280 U.S. 478, 74 L. Ed. 556; *National Bank* v. *United States*, 107 U.S. 445, 27 L. Ed. 537; *Davis* v. *Pringle*, 268 U.S. 315, 69 L. Ed. 974); and, that the allowance of the priority would be inconsistent with the purpose for which the priority was granted. (*Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23; *United States* v. *Marxen*, 307 U.S. 200, 87 L. Ed. 1222).

The referee denied priority on the ground that the S.B.A. is a separate entity. (R. 33-36). The District Court denied priority on the ground that there was a post bankruptcy assignment. (R. 38-43). The Court of Appeals held the determining fact to be:

> "* * * that SBA has by written contract with the bank agreed to share ratably the proceeds and losses resulting from the transaction with Byquist.

"Marxen holds that absent controlling legislation, which is not present here, section 3466 grants priority only to the United States. In *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 28, it was said that section 3466 may not be extended to create a priority for a claim which the United States is collecting for a private party. This principle would be violated if the claim of the United States were here given priority.

"The United States is bound by its written contract to the bank for the bank's 25% share of any collection made under the note. Hence, the bank would share to that extent in any proceeds resulting from the award of a priority to the United States. No such priority in a private creditor is provided by section 3466.

"The Bankruptcy Act is intended to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands. The use of section 3466 to prefer the bank over other private creditors would defeat that intent.

"The United States has engaged in a commercial enterprise and made no effort to safeguard its rights under section 3466. In a contract made on its own forms it has agreed to share ratably proceeds and losses. It may not assert a priority which will produce a recovery that by contract must be divided with a private entity." (R. 49).

The Small Business Administration duly filed a petition for certiorari which was granted on April 18, 1960. (R. 51).

SUMMARY OF THE ARGUMENT.

Small Business Administration contends that it is entitled to priority by virtue of Section 64, Fifth (11 U.S.C.A. §104(5)) of the Bankruptcy Act providing a priority of the fifth class to "debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, * * *", and by virtue of R.S. §3466 (31 U.S.C.A. §191) which provides, "whenever any person indebted to the United States is insolvent, * * * the debt due to the United States shall be first satisfied; * * *".

It has often been stated the purpose of R.S. §3466 is to secure adequate public revenues to sustain the public burden and discharge the public debt. It is also well established that the statute is to be liberally construed to effectuate that purpose. See *e. g., United States* v. *Emory*, 314 U.S. 423, 86 L. Ed. 315; *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23.

"But the rule of liberal construction has its limitations beyond which a Court cannot go" (*U. S. v. Johnson*, (C.A. 10) 87 F.2d 155, 161), and "this Court has in the past recognized that certain exceptions could be read into this statute." (*United States* v. *Waddill, Holland & Flynn*, 323 U.S. 353, 354, 89 L. Ed. 294, 299).

It has thus been held that the priority does not arise in the following situations:

1. When the allowance of the priority would be inconsistent with the purpose for which the priority was granted. *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23; *United States* v. *Marxen*, 307 U.S. 200, 84 L. Ed. 1222.

2. When the allowance of the priority would be inconsistent with other statutes and acts of Congress. *United*

States v. *Guaranty Trust Company*, 280 U.S. 478, 74 L. Ed. 556; *National Bank* v. *United States*, 107 U.S. 445, 27 L. Ed. 537; *United States* v. *Sampsell*, (C.A. 9) 153 F.2d 731; *Davis* v. *Pringle*, 268 U.S. 315, 69 L. Ed. 974.

3. To general claims in bankruptcy transferred to the United States, or to which it has become subrogated on payment, after the filing of the petition in bankruptcy. *United States* v. *Marxen*, 307 U.S. 200, 83 L. Ed. 1222.

4. When the debt is not due to the United States as such. It is not one owing to the United States merely because it is owed to an agency of the United States. It depends in each case upon the nature of the agency and the nature of the debt. *Sloan Corporation* v. *United States Shipping Board*, 258 U.S. 549, 66 L. Ed. 726; *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23.

I.

Respondent submits that the allowance of a priority in this case would be inconsistent with the purpose of R.S. §3466; inconsistent with the purpose of the Bankruptcy Act; and, inconsistent with the purpose of the Small Business Act itself. Points 1 and 2 above will be argued together in this brief.

It is conceded that the S.B.A. will be required to share with the Brookville State Bank any recovery it obtains in excess of the dividend to ordinary creditors. To the extent that it is required to share this recovery, the proceeds will not be available "to sustain the public burden and discharge the public debt", but rather will redound to the benefit of a private entity, thus thwarting the purpose of R.S. §3466.

The purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate among

creditors holding just demands. By virtue of receiving a share of proceeds of the bankrupt's estate distributed to S.B.A., the Brookville State Bank, a common creditor with no superior equities, would be preferred over the other common creditors, and the purpose of the Bankruptcy Act would be thwarted.

The declared purpose of the Small Business Act is to aid and foster small business by extension of credit with the intention of encouraging and developing the actual and potential capacity of small business, and to allow for their expansion and growth, thus maintaining and strengthening the overall economy of the nation. If suppliers of goods and services knew that in the event of insolvency their claims would be subordinated to those of the United States, they would refuse to extend credit to those concerns, whose very credit S.B.A. is attempting to foster and promote, and thus the purpose of the Small Business Act would be thwarted. Additionally, the Small Business Act unmistakably evidences a purpose to rely on other means than the priority provided for by R.S. §3466 to obtain repayment of advances.

II.

There was no debt due to S.B.A., or the United States at the date of bankruptcy.

The claim of S.B.A. is based on a note executed by the bankrupt and payable to the Brookville State Bank. On the date of bankruptcy the Bank was the holder and sole payee on the note. Subsequent to the adjudication in bankruptcy the note was assigned to S.B.A. S.B.A. then filed its claim on the note against the bankrupt. Prior to the assignment of the note, S.B.A. had no enforceable claim of any kind against Byquist. Under such a state of facts this Court has held that the United States as assignee

has no greater rights than the assignor possessed prior to the assignment.

While S.B.A. had entered into an agreement with the Bank in connection with this loan, there was no privity between S.B.A. and Byquist. S.B.A. was not a party-lender, nor did its purchase of a participation from the bank purport to constitute an assignment of the note or any part of it to S.B.A. S.B.A. obtained the right to participate with the bank in the proceeds of the loan and the right to a future assignment of the note from the bank on demand. Under its agreement, S.B.A.'s rights were against the bank and not against Byquist. Until the assignment of the note occurred there was no debt due from Byquist to the S.B.A.

III.

A debt due the S.B.A. is not a debt due to the United States within the meaning of R.S. §3466.

The immunities and priorities of the United States do not extend to separate entities through which it may choose to transact its business. The Small Business Act creates an agency under the name, "Small Business Administration" which is under the general direction and supervision of the President and is not affiliated with or within any other agency or department of the federal government. The management of the Administration is vested in an administrator appointed by the President. It is authorized to obtain money from a revolving fund in the Treasury of the United States for use in the performance of the powers and duties granted to or imposed upon it by law. It must pay interest on the net amount drawn at the end of each fiscal year. It may enter into contracts, including the power "to enter into contracts with the United States Government and any department, agency or officers

thereof", buy and sell property, and sue and be sued in any court of record of a state having general jurisdiction or in any United States District Court. The various powers granted to the Small Business Administration constitute it a separate legal entity. No priority is specifically granted to it, and it is not entitled to claim the priority granted to the United States. No debt is here owed to the United States. Upon its acquisition of the note, a debt became due to the Small Business Administration. The administration is obligated to pay "at the close of each fiscal year, interest on the net amount of cash disbursements from advances" made to it. It is not required to account for specific loans to the United States. Any recovery here will go to the revolving fund of the S.B.A., which, although maintained in the Treasury of the United States, is not a payment to the United States. Assuming the Administration has followed the Congressional mandate, and that the totality of loans made have been of "such sound value or so secured as reasonably to assure repayment", it is difficult to see where the United States as such, would stand to gain or lose, as a result of any claim made by the Small Business Administration.

ARGUMENT.

I.

Allowance of the Priority Would Be Inconsistent with Other Statutes and Acts of Congress.

A. R.S. 3466 and the Bankruptcy Act

On October 15, 1957, the S.B.A. filed its proof of claim in bankruptcy in this matter. The claim is for $16,788.42 (it was subsequently stipulated the correct figure, after all credits were given, is $16,355.69 (R. 32)) and alleges "said

sum represents the total indebtedness due and payable by bankruptcy by virtue of the failure to repay to Small Business Administration the indebtedness arising from the loan made by the Brookville State Bank, Brookville, Kansas, to said Bankrupt; * * *" (R. 2-3). The claim further alleges:

> "4. That the consideration of said indebtedness is as follows:
>
> (a) A Note in the principal amount of $20,000.00, duly executed and delivered to the said bank and thereafter assigned to the Small Business Administration pursuant to the Participation Agreement, attached as 'Exhibit A'. Attached hereto and made a part hereof and marked 'Exhibit B' is a photostatic copy of the above-mentioned Note." (R. 3).

The participation agreement attached to the proof of claim as Exhibit "A" is an agreement between the Brookville State Bank and the Small Business Administration. It recites that S. H. Byquist, d/b/a Western Distributors, has made application for a loan in the amount of $20,000.00 and S.B.A. desires to purchase a participation of 75% of the loan. The agreement provides:

> "2. Purchase of Participation.—SBA, upon written demand by Bank, will purchase from Bank a participation of 75 per cent of each disbursement made by Bank to Borrower on account of the Loan, immediately after such disbursement, for an amount of money equal to the amount of said participation. Immediately upon each such purchase, Bank will execute and deliver to SBA a Participation Certificate on SBA Form 152* evidencing the interest in the Loan so purchased. (Exhibit A; ¶ 2, R. 4).
>
> * * *

"10. Advice to SBA.—Immediately upon making each disbursement to Borrower on account of the Loan, Bank will advise SBA in writing of the date and amount of such disbursement. Immediately upon receipt by Bank of any payment by Borrower of principal of or interest on the Loan, Bank will advise SBA in writing of the date and amount of each such payment. Upon the happening of any default by Borrower under the provisions of the Note or any other agreement in connection with the Loan, coming to the knowledge of Bank, Bank will within ten days thereafter forward appropriate notice thereof to SBA. Bank will at any time and from time to time, forward to SBA such other information and advice in connection with the Loan as SBA may request. If and when requested by SBA, Bank will furnish SBA with a conformed copy of the Note, instruments of hypothecation and all other agreements and documents obtained by Bank in connection with the Loan. (Exhibit A, ¶ 10, R. 7).

* * *

"11. Possession of Note and Collateral.—Bank shall, * * * hold the Note, all the collateral therefor and all instruments delivered in connection therewith; Provided, however, That subsequent to the purchase by SBA of a participation in the Loan and upon written demand Bank shall five days after receipt of said demand transfer to SBA, without recourse, the Note, collateral, and instruments, all of which shall thereafter be held by SBA, and simultaneously therewith SBA shall issue to Bank a Certificate of Interest (on SBA Form 156*) evidencing the interest retained by Bank in the Loan. (Exhibit A, ¶ 11, R. 8).

"12. Administration of Loan.—The holder of the Note shall receive all payments on account of principal of, or interest on, the Loan and promptly remit to the other party its pro rata share thereof determined according to their respective interests in the Loan, * * *. (Exhibit A, ¶ 12, R. 8).

* * *

expect to receive would be approximately 2% if, in fact, they received any dividend at all. If the priority should be allowed as to $12,266.77, of this $16,355.69 claim and the balance be allowed as a common claim, there would be a total recovery on the claim of $12,348.53, assuming a 2% dividend on the balance. Under the participation agreement on which S.B.A. bases its claim, $3,087.13 of this amount would be payable to the Brookville State Bank.

The Brookville State Bank would therefore receive from the assets of the bankrupt approximately 75% of its claim, while the other common creditors receive only 2%.

> "The broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands * * *." (*Kothe* v. *R. C. Taylor Trust*, 280 U.S. 224, 227, 74 L. Ed. 382).
>
> "The theme of the Bankruptcy Act is 'equality of distribution' (*Sampsell* v. *Imperial Paper & Color Corp.*, 313 U.S. 215, 219, 85 L. Ed. 1293, 1298, 61 S. Ct. 904); and if one claimant is to be preferred over others, the purpose should be clear from the statute." (*Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 29, 97 L. Ed. 23, 29).

Here, the bank as a common creditor with no superior equities, would be preferred over other common creditors contrary to the purpose of the Bankruptcy Act to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands. The S.B.A., on the other hand, would not enjoy the fruits of the priority since under the participation agreement it would not retain the amount for which the priority was allowed.

In *United States* v. *Marxen*, 307 U.S. 200, 83 L. Ed. 1222, this Court, after announcing the principle that R.S. §3466 is

"14. Liability and Representations.—Neither party hereto makes any express or implied warranty of any kind with respect to the Loan and neither party shall be liable to the other for any loss, not due to its own gross negligence, but such loss shall be borne ratably by SBA and Bank in accordance with their respective interests in the Loan." (Exhibit A, ¶ 14, R. 9).

The claim of the S.B.A. filed herein is for the full unpaid balance of the note. It is prosecuting this claim for itself and for the Brookville State Bank as their interests may appear. By the terms of the participation agreement, the S.B.A., as holder of the note, must remit promptly to the bank its pro rata share of any recovery obtained. The participation agreement also provides "any loss * * * shall be borne ratably by SBA and Bank in accordance with their respective interests in the Loan."

If this claim is allowed in full and an ordinary dividend paid upon it, and if the S.B.A. remits to the bank its pro rata share of that dividend, all of the requirements of the participation agreement will have been fulfilled. S.B.A. and the bank will have shared ratably the proceeds of the note, and the loss will have been borne ratably by S.B.A. and the bank in accordance with their respective interests in the loan.

S.B.A. from the outset has recognized that a part of the amount which it seeks to collect it is collecting for and on behalf of the bank. In asserting its priority, in a partial recognition of the participation agreement, it has claimed priority for only 75% of the total claim, or $12,266.77.

Let us examine the practical result of the allowance of a priority in that amount in this case. If no priorities are allowed, all of the creditors will receive a dividend of approximately 30%. If the priority claimed by S.B.A. were allowed, the greatest dividend the common creditors could

to be construed liberally to effectuate its purpose to protect the public revenues said:

> "But this principle of construction is subject to the limitation that the generality of the language of the section is restricted by the purpose to grant priority to the United States, only, and by legislative intention, as shown by other statutes." (206).

In *Nathanson* v. *National Labor Relations Board*, 344 U.S. 25, 97 L. Ed. 23, it was said that R.S. §3466 may not be extended to create a priority for a claim which the United States is collecting for the benefit of a private party.

S.B.A. acknowledges that a part of its total claim of $16,355.69 is being collected on behalf of the Brookville State Bank. By the same reasoning by which S.B.A. initially claimed priority to only $12,266.77, it might claim priority to only $9,261.40, the amount it would be entitled to retain under the distribution set out above. Here, again, however, while the dividend to the common creditors would be somewhat increased, the recovery by S.B.A. by virtue of its priority would have to be shared with the bank under the participation agreement. This again would result in an inequitable preference of the bank, and S.B.A. would not retain the amount recovered by virtue of the priority.

The only point at which a dividend can be allowed on this claim without resulting in a sharing by S.B.A. and a preference to the bank, thus satisfying and enforcing the provisions of both the participation agreement and the Bankruptcy Act, is by allowance of the claim as a common claim without priority. At that point, and at that point only, the bank and S.B.A. will share ratably, according to their respective interests in the loan, the proceeds of the loan and the loss sustained on the loan, so that no amount

will be due by either to the other, and no inequitable preference will result to the bank.

Insofar as any amount is recovered by the Small Business Administration in excess of an ordinary dividend, a part of that excess must be divided with the bank. So much of the recovery as must, under the participation agreement, go to the bank, is not satisfying a debt due to the United States. The collection of that amount by Small Business Administration is for the benefit of a private party.

Petitioner, in its brief, distinguishes the *Nathanson* case on the ground that whereas, in *Nathanson* the United States was not the beneficial owner of any part of the debt, in this case it is.

It is true that in *Nathanson* the Board had no beneficial interest in the claim. It is true, also, that in this case S.B.A. had paid out of its revolving fund, $15,000.00 to the Bank for the purchase of an interest in a loan which the bank had theretofore made by Byquist. And, it is true that this had turned out to be a poor investment and only some $3,750.00 of its principal had been recovered at the time of bankruptcy. But, at the time the agreement with the bank was entered into, the parties recognized the risks attendant upon the lending of money, and so they inserted a clause in their contract with respect to losses. They provided that neither party should be liable to the other for any loss, not occasioned by its own gross negligence, and that "such loss, shall be borne ratably by S.B.A. and Bank in accordance with their respective interests in the Loan."

We submit that the "beneficial interest" of S.B.A. must be determined by the entire contract with the bank. Its "beneficial interest" certainly must be limited to the amount by which it will benefit. May the S.B.A. assert

a priority for $12,000.00 of which it may retain only $9,000.00, and contend it is "beneficially interested" in the entire $12,000.00? Would not the $3,000.00, it thereby recovered, be recovered for the benefit of a private party? It has a beneficial interest in a priority on $12,000.00 only because a priority in that amount would reduce the loss sustained by both the bank and S.B.A., and it could retain more of the amount recovered. Can it then be said that S.B.A. has a beneficial interest in $9,000.00, and the priority should be allowed in that amount? We submit it cannot. In that event S.B.A. would still be required to share the amount recovered with the bank, and as petitioner says in its brief "and so on, *ad infinitum*".

Petitioner, in its brief, suggests two solutions to this problem. First, that the priority be allowed for the full amount of the note, to assure that the lesser amount claimed by S.B.A. will be paid in full; and, second, that the Court simply allow the S.B.A. to breach its contract, and deny the bank any participation.

While it is true that by allowing a priority for the full $16,000.00, the S.B.A., in this case, would recover substantially all of its money; that would do violence to the priority statute, as well as be directly contrary to the decision of this Court in the *Nathanson* and *Marxen* cases. It does, however, serve to point up the argument we have made above.

S.B.A. has never contended that either Byquist or the bank was ever indebted to it or the United States in any such sum. It is only by allowing some other private entity to also have a priority that the debt due to S.B.A. could be satisfied. The result would not be that the debt due the United States was first satisfied, but that the debt due the United States and some other person or entity were satisfied.

Marxen says that R.S. §3466 grants priority to the United States only. *Nathanson* says R.S. §3466 may not be extended to create a priority for a claim which the United States is collecting for a private party.

As to the suggestion that a proper solution would be to simply disregard the obligations of the contract, and allow the bank to participate in any recovery by S.B.A., on the ground that it is against public policy, suffice it to say that Congress specifically authorized just such a contract as was here made.

The Small Business Act provides:

> "(a) The Administration is empowered to make loans * * * and such loans may be made or effected either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred basis." (15 U.S.C. §636 (a)).

By its participation with ordinary commercial banks or other lending institutions, in ordinary commercial loans, the claims made by Small Business Administration are so affected by a private non-governmental interest that the allowance of any priority would be inequitable and inconsistent with the purposes of the Bankruptcy Act, and with R.S. §3466 itself.

As early as 1824, in *Bank of the United States* v. *Planters Bank*, 9 Wheat. 904, 6 L. Ed. 244, this Court said:

> "It is, we think, a sound principle, that when a Government becomes a partner in any trading company, it divests itself, so far as concerns the transactions of that company, of its sovereign character, and takes that of a private citizen. Instead of communicating to the company its privileges and its prerogatives, it descends to a level with those with whom it associates itself, and takes the character which belongs to

its associates, and to the business which is to be transacted. * * *"

In *Mellon* v. *Michigan Trust Co.*, 271 U.S. 236, 70 L. Ed. 924, the Court said:

> "As said in *Davis* v. *Pullen*, (C.C.A. 1st) 277 Fed. 650, 655, 'there is a certain obvious injustice in giving the United States when engaged in an industrial and commercial venture, even although under war powers, superior rights over other creditors bearing like relations to insolvents.'"

And the Court found it unnecessary to cause such injustice and held:

> "To permit the claim preference, we think, would conflict with the spirit and broad purpose of the statute. These become plain enough upon consideration of the just ends which Congress had in view together with the recent policy, revealed by the Bankruptcy Act, in respect to priorities."

B. The Small Business Act.

We believe the allowance of the claimed priority would be plainly inconsistent with the declared and apparent purposes of the Small Business Act, and on the authority of *United States* v. *Guaranty Trust Co.*, 280 U.S. 478, 74 L. Ed. 556, the claimed priority should be denied.

While it has been held that only the plainest inconsistency between R.S. §3466 and subsequent Congressional legislation warrants the finding of an implied exception to the statute, it has been clearly recognized that where such inconsistency exists R.S. §3466 is inapplicable. *United States* v. *Guaranty Trust Co.*, 280 U.S. 478, 74 L. Ed. 556; *United States* v. *Emory*, 314 U.S. 423, 86 L. Ed. 315; *National Bank* v. *The United States*, 107 U.S. 445, 27 L. Ed. 537; *United States* v. *Remund*, 330 U.S. 539, 91 L. Ed. 1082; *Massachusetts* v. *United States*, 333 U.S. 611, 92 L. Ed. 968.

In *United States* v. *Guaranty Trust Co.*, 280 U. S. 478, 74 L. Ed. 556, the claims arose out of Title II of the Transportation Act of 1920. That act provided for the funding of debts which the railroads had contracted during the period of war time control, and also provided for new loans to the railroads. The Court held R.S. §3466 inapplicable to the collection of these loans. The Court found that at the time of the passage of the act most of the railroads of the United States "lacked funds for necessary improvements, equipment, and expansion of facilities." (p. 484). Some of the carriers needed funds to meet maturing obligations. The credit of many carriers was seriously impaired. There was a reluctance among investors to purchase new railroad securities. "Congress deemed it important to preserve for the nation substantially the whole existing transportation system." (p. 484). In order to accomplish this, it was thought necessary that the United States should finance the carriers until it would become possible to restore their credit. The provisions of Title II of the Transportation Act were framed to that end. The Court held, "to have given priority to debts due the United States pursuant to Title II would have defeated the purpose of Congress." (p. 485). The Court said that the allowance of the priority not only would have prevented the re-establishment of railroad credit, but would even have seriously impaired the market value of outstanding railroad securities. "It would have deprived the carriers of the credit commonly enjoyed from supply men and others; would have seriously embarrassed the carriers in their daily operations, and would have made necessary a great enlargement of their working capital." (p. 485). The Court concluded, "the entire spirit of the act makes clear the purpose that the rule leading to such consequences should not be applied." (p. 485).

The Court also found in that case that Congress evidenced unmistakably its purpose to rely, for obtaining payment of the Government advances, upon other means than the priority provided for by R.S. §3466. The evidence found by the Court was that "under all of the sections, the giving of adequate security was either required or left to the discretion of the President"; that "no advance could be made, unless the Interstate Commerce Commission was satisfied that the earning power of the carrier and the security given furnished reasonable assurance that the loan would be repaid and all obligations in connection therewith would be performed." (p. 485). The Court then concluded, "thus, both the general purposes of Title II and its specific provisions make it clear that Congress intended to exclude the indebtedness so arising from the scope of §3466 of the Revised Statutes, * * *." (p. 486).

The general purposes of the Small Business Act and its specific provisions make it equally clear that Congress intended to exclude indebtedness arising under that Act from the scope of R.S. §3466; and, in the Small Business Act, as in the Transportation Act, Congress evidenced unmistakably its purpose to rely, for obtaining payment of the Government's advances, upon other means than the priority provided for by R.S. §3466.

The purpose of the Small Business Act is set forth in its first section (15 U.S.C. §631), which states:

> "(a) The essence of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this nation.

Such security and well-being cannot be realized unless the actual and potential capacity of small business is encouraged and developed. It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts for property and services for the Government (including but not limited to contracts for maintenance, repair, and construction) be placed with small business enterprises, to insure that a fair proportion of the total sales of Government property be made to such enterprises, and to maintain and strengthen the overall economy of the nation."

To carry out this policy:

"(a) The administration is empowered to make loans to enable small business concerns to finance plant construction, conversion, or expansion, including the acquisition of land; or to finance the acquisition of equipment, facilities, machinery, supplies, or materials; or to supply such concerns with working capital to be used in the manufacture of articles, equipment, supplies, or materials for war, defense, or civilian production or as may be necessary to insure a well balanced national economy; * * *" (15 U.S.C. §636(a)).

This language is substantially identical with the language of the Court in the *Guaranty Trust Company* case where it said:

"These appropriations were made in order to meet a pressing need. At the time of the passage of the Transportation Act 1920, most of the railroads of the United States lacked funds for necessary improvements, equipment, and expansion of facilities." (p. 484).

Sound business requires a good credit standing and a substantial line of open account credit with suppliers of

goods and services. It is particularly essential to small business. Without such credit the working capital requirements of such a business would be overwhelming.

The declared policy of the Congress is to "aid, counsel, assist, and protect" the interests of small business concerns in order to preserve free competitive enterprise. "Only through full and free competition can free markets, free entry into business and opportunities for the expression and growth of personal initiative and individual judgment be assured."

To give priority to debts due the S.B.A. would defeat the purpose of Congress. We submit that if suppliers of goods and services knew that in the event of insolvency their claims would be subordinated to those of the S.B.A., they would refuse to extend credit to these concerns whose very credit the S.B.A. is attempting to foster and promote. In that event the obtaining of an S.B.A. loan would certainly be a prelude to bankruptcy.

Petitioner, at page 38 of its Brief, points out that "an identical argument was made to this Court in *United States* v. *Emory*, 314 U.S. 423, 86 L. Ed 315, as a reason for not granting priority to a loan made pursuant to the National Housing Act", and that the Court rejected the argument in that case.

In the *Emory* case the Court held that the purpose of the National Housing Act "was not the strengthening of the general credit of the property owners [the borrowers], but the stimulation of the building trades by affording assurances to lending institutions in order to induce them to make loans for property improvements. No security was required of the borrowers, and the interest charge was low." (p. 433).

No embarrassment would be caused to the building trades, the trade intended to be benefited under the National Housing Act, by enforcement of the priority against the borrower, the property owner, in case of default.

That is not the case here. Under the Small Business Act, the purpose, as stated in the act itself is to benefit the borrowers, the small business organizations, and they would be embarrassed by the enforcement of the priority, and the purpose of Congress to benefit them would be defeated.

Petitioner also points out that the argument was again rejected in *United States* v. *Remund*, 330 U.S. 539, 91 L. Ed. 1082. That case involved emergency feed and crop loans made by the Farm Credit Administration. As to the purpose for which those loans were made, this Court said:

> "But it is manifest that the purpose of the acts of February 23, 1934, and June 19, 1934, was to give emergency relief to distressed farmers rather than to restore their credit status. These were but two of a series of emergency seed and crop loan statutes enacted at the various times from 1921 to 1938, a period when farmers were the victims of repeated crop failures and adverse economic conditions. Their credit was often impaired, but their most urgent need was for money to purchase feed and to plant crops; without such money, distress and unemployment might have been their lot. It was to meet that urgent need that Congress passed these statutes." (pp. 543-544).

The Court concluded:

> "We conclude that there is no irreconcilable conflict between giving emergency loans to distressed farmers and giving priority to the collection of these loans pursuant to section 3466. Such priority could in no way impair the aid which the farmers sought through these loans; nor could it embarrass the farmers

in their daily operations. Moreover, these loans called for a first lien on crops growing or to be grown, or on livestock. The conditions prevailing in 1934, made this type of security uncertain and there is no indication that Congress meant such a lien to be the sole security to which the Government could look for repayment." (p. 544).

The situation here is wholly unlike that considered in the *Emory* case, where a trade with whom the borrower would do business was intended to be benefited rather than the borrower himself, or the *Remund* case where the purpose was to give emergency loans to distressed farmers. Under the Small Business Act "the actual and potential capacity of small business is [to be] encouraged and developed." This capacity certainly will not be encouraged and developed by a course of action tending to curtail or restrict open lines of credit.

The purpose to rely upon other means than the priority provided for by R.S. §3466 is clearly evidenced in the Small Business Act and the regulations promulgated pursuant thereto.

The act provides:

"(7) All loans made under this sub-section shall be of such sound value or so secured as reasonably to assure repayment." (15 U.S.C. §636(a)(7)).

The loan policy statement in regard to business loans contained in the regulations promulgated under the Small Business Act provide:

"(c) No loan shall be made unless there exists reasonable assurance that it can and will be repaid pursuant to its terms. Reasonable assurance of repayment will exist only where the loan is of sound value, or is adequately secured in the judgment of SBA. It will be deemed not to exist when the proposed loan is

to accomplish an expansion which is unwarranted in the light of the applicant's past experience and management ability, or when the effect of making the loan is to subsidize inferior management." (13 CFR §120.4-2 (c)).

And in the regulations relating to limited loan participation, it is provided:

"(c) Emphasis shall be on the repayment ability of the borrower as determined from the record of past earnings.

"(d) All such loans shall be secured; however, the participating bank shall be responsible for obtaining the pledge of collateral as well as determining the adequacy thereof. Security may include, but shall not be limited to, mortgage on real or personal property, assignment of accounts receivable or moneys due on contracts, pledge of warehouse receipts and guarantees." (13 CFR §120.4-4(c)(d)).

The declared purpose of the Small Business Act for the well-being of the nation is to encourage and develop the potential capacity of small business by making money and credit available to such businesses and to aid, counsel, assist and protect insofar as possible the interests of small business concerns. Both the general purposes of the Small Business Act and its specific provisions make it clear that Congress intended to exclude the indebtedness so arising from the scope of R.S. §3466.

II.

No Debt Was Due to SBA or the United States at the Date of Bankruptcy.

It is now settled that the status of a claim against a bankrupt is fixed at the date the petition is filed. Where a claim is thereafter transferred or assigned to the United

States, the United States as assignee is entitled to no greater rights than its assignor, and priority under R.S. § 3466 will be denied. *United States* v. *Marxen*, 307 U.S. 200, 83 L. Ed. 1222; *Sexton* v. *Dreyfus*, 219 U.S. 339, 55 L. Ed. 244; *Groggin* v. *Labor Division*, 336 U.S. 118, 93 L. Ed. 543; *In Re Hansen Bakers*, 103 F.2d 665; *In Re Miller*, 105 F.2d 926; *Corman* v. *Federal Housing Admr.*, 113 F.2d 743.

This claim is based upon a note executed by S. H. Byquist to the Brookville State Bank. The proof of claim filed by the S.B.A. herein states the consideration of said indebtedness is "a Note in the principal amount of $20,000.00, duly executed and delivered to said Bank and thereafter assigned to the Small Business Administration * * *". (R. 3). It has been stipulated that the note was assigned to Small Business Administration following the adjudication of S. H. Byquist a bankrupt. (R. 32).

On the date of bankruptcy, the Brookville State Bank was the holder and sole payee of the note. Prior to the assignment of the note to it, S.B.A. had no enforceable claim of any kind against Byquist. There was no privity between S. H. Byquist and the Small Business Administration.

At the date of bankruptcy the only contract in which Small Business Administration was interested was a contract with the Brookville State Bank. By that contract Small Business Administration agreed to purchase a part of a loan proposed to be made by the Brookville State Bank. S.B.A. was not a party lender. The Brookville State Bank was to continue as the holder and owner of the note. It was obligated to account to Small Business Administration for its pro rata share of each payment made by the borrower, and to use due diligence to recover all payments from the borrower. S.B.A. obtained the right to participate with the bank in the proceeds of the loan, and the right to demand an assignment of the note and col-

lateral. The bank was obligated to make such assignment within five (5) days after receipt of a written demand for such transfer. Until such assignment was made, S.B.A.'s only recourse was against the bank. At the time the bankruptcy proceedings were instituted, the Small Business Administration had no enforceable claim against the bankrupt.

All of the evidence in this case shows that no present assignment of all or any part of the note was intended by either the bank or S.B.A. by the purchase of a participation therein by S.B.A.

The participation agreement between S.B.A. and the bank, in paragraph 11, provides:

> "* * * That subsequent to the purchase by SBA of a participation in the Loan and upon written demand Bank shall five days after receipt of said demand transfer to SBA, without recourse, the note, collateral, and instruments, all of which shall thereafter be held by SBA, * * *" (Exhibit A, ¶ 11, R. 8).

This gives the S.B.A. a right to demand an assignment in the future, a right against the bank; it negatives any idea that a present assignment of the note was intended.

An agreement to assign or an unexecuted intent to assign at some time in the future is not an assignment.

Southern Lumber Company v. *Pearce*, 59 F.2d 50 (C.A. 5);

Turner v. *Williams*, 114 Kan. 769, 773-774, 221 Pac. 267, 269.

Since no present assignment of the debt was intended by either of the parties, S.B.A. could not even have contended that there was an equitable assignment enforceable by it against the bankrupt. If an assignment was to be made, it would be made at a future time. Until such an

assignment was made, the debt was owed to the bank alone as payee in the note. Until an assignment was made, S.B.A. could not have instituted any action against S. H. Byquist. What S.B.A. had by virtue of its contract with the bank, and by purchase of a participation in the loan, was a right to participate in the proceeds of the loan as they were paid; and, the right to demand an assignment of the loan.

Recognizing that it had no enforceable claim against the bankrupt until the assignment of the note was made, and subsequent to the institution of the bankruptcy proceedings, S.B.A. demanded and obtained an assignment of the note, and filed its claim for the full unpaid principal balance of the note. This was properly done. Its claim, however, is an assigned claim in which the assignment occurred after the date of bankruptcy and it is not entitled to priority.

The S.B.A., in its brief filed herein, takes the position that from the time S.B.A. bought its participation in the loan, it was necessarily a creditor of the bankrupt. In support of its position petitioner cites *In re Westover, Inc.*, 82 F.2d 177 (C.A. 2); *In re Prudence Bonds Corp.*, 79 F.2d 212 (C.A. 2); *Delatour* v. *Prudence Realization Corp.*, 167 F.2d 621 (C.A. 2); *In re Prudence Co.*, 89 F.2d 689 (C.A. 2), holding that the holders of participation certificates issued by a mortgagee evidencing participating interest in the mortgage and bond are creditors of the mortgagor, not of the mortgagee. It also cites *In re Hawley Down-Draft Furnace Co.*, 238 Fed. 122 (C.A. 3); *Cogan* v. *Conover Mfg. Co.*, 69 N.J. Eq. 809, 64 Atl. 973, on the proposition that ownership rights of an assignee are unaffected by his designation of the assignor as collecting agent.

These cases are all clearly distinguishable from the case at bar, and are not in point here.

The *Westover* and *Prudence* cases are all substantially companion cases. Each involved "participation certificates" issued by the Prudence Company. In each case the Court is careful to point out that the participation certificates were intended to and did constitute a present assignment of an undivided share of the mortgage.

Hawley Down-Draft Furnace Co. and the *Cogan* case each involved an assignment of accounts receivable without notice to the debtors. In each case there was, however, a present written assignment of the account as between the assignor and assignee.

In the case at bar neither the participation agreement nor the participation certificate issued in pursuance thereof is intended to constitute a present assignment of any part of this note. On the contrary, they show only a right to an assignment in the future. We are not here saying that the parties could not have made a present partial assignment of a part of the note,[1] but rather that they did not do so, nor attempt to do so.

The "participation certificate" executed and delivered by the bank to S.B.A. in the present case, is simply an acknowledgement by the bank of the purchase from it by S.B.A. of a participation in the loan with a right to an assignment at a subsequent time on demand by S.B.A. It does not constitute or purport to constitute an assignment of any part of the loan to S.B.A. It does not operate

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1. But see, Uniform Negotiable Instruments Law §32, which provides:

> "The Indorsement must be an indorsement of the entire instrument. An indorsement, which purports to transfer to the indorsee a part only of the amount payable, or which purports to transfer the instrument to two or more payees severally, does not operate as a negotiation of the instrument. But where the instrument has been paid in part, it may be indorsed as to the residue."

to make S.B.A. a creditor of the bankrupt. S.B.A. did not become a creditor of the bankrupt until the assignment of the note to it after bankruptcy.

III.

Debts Due to SBA Are Not Debts Due to the United States.

The United States doing business through a separate entity does not extend its sovereign immunities or its priorities to such entity unless specifically granted.

Sloan Shipyard Corp. v. *United States Shipping Board*, 258 U.S. 549, 66 L. Ed. 762;

RFC v. *J. H. Menihan Corp.*, 312 U.S. 81, 85 L. Ed. 595;

Nathanson v. *NLRB*, 344 U.S. 25, 97 L. Ed. 23;

United States v. *Edgerton & Sons*, 178 F.2d 763 (C.A. 2).

We submit that the act creating the Small Business Administration created an independent entity not invested with the sovereign privileges, immunities and priorities of the United States.

The Small Business Act (15 U.S.C. §§631-651) created an agency under the name "Small Business Administration". It is under the general direction and supervision of the President "and shall not be affiliated with or be within any other agency or department of the federal government." (§633(a)). The management of the administration is vested in an administrator appointed by the President. (§633(b)).

The administration is authorized to obtain money from the Treasury of the United States for use in the performance of the powers and duties granted to or imposed upon it by law. For that purpose an appropriation is made to

a revolving fund in the Treasury. "The administration shall pay into miscellaneous receipts of the Treasury, at the close of each fiscal year, interest on the net amount of cash disbursement from such advances at a rate determined by the Secretary of the Treasury, * * *". (§633(c)).

The administration is given the power to adopt, alter and use a seal which shall be judicially noticed. (§634(a)). It may sue and be sued in any court of record of a state having general jurisdiction, or in any United States District Court. (§634(b)(1)).

It may enter into contracts, including contracts with the United States Government and any department, agency or officer thereof. (§637(a)(1)); acquire in any lawful manner, any property, real, personal or mixed, tangible and intangible (§634(b)(5)); may assign or sell at public or private sale, or dispose of for cash or credit, upon such terms and conditions and for such consideration as the administrator shall determine to be reasonable, any evidence of debt, contract, claim, personal property or security assigned to or held by it, and may collect or compromise all obligations assigned to or held by it (§634(b)(2)(4)); and, it may deal with, complete, renovate, improve, modernize, insure, or rent or sell for cash or credit upon such terms and conditions, and for such consideration as the administrator shall determine to be reasonable any real property conveyed to or otherwise acquired in connection with the payment of loans (§634(b)(3)).

It is empowered to make loans to enable small business concerns to finance plant construction, conversion, or expansion, including the acquisition of land; to finance the acquisition of equipment, facilities, machinery, supplies, or materials; to supply such concerns with working capital to be used in the manufacture of articles, equip-

ment, supplies, or materials for war, defense, or civilian production, or as may be necessary to insure a well-balanced national economy. It may make such loans either directly or it may join with and cooperate with ordinary commercial banks or other lending institutions through agreements to participate on an immediate or deferred basis: (§636(a)).

While it is not organized as a federal corporation, the Small Business Administration has all of the powers ordinarily to be found in a corporate charter and the powers granted to it clearly constitute it a separate entity.

In its brief in this case petitioner, at page 35, states:

> "It is now firmly established that a non-incorporated agency of the United States must be regarded as the United States for the purposes of R.S. §3466."

In support of this statement it cites *United States* v. *Remund*, 330 U.S. 539, 91 L. Ed. 1082; *United States* v. *Emory*, 314 U.S. 423, 86 L. Ed. 315; and *Korman* v. *Federal Housing Administrator*, 113 F.2d 743 (C.A.D.C.). An examination of those cases will indicate that petitioner's statement is too broad.

In the *Remund* case the Court found that the Farm Credit Administration "bears none of the features of a Government corporation with a legal entity separate from the United States" and "hence any debt owed the Farm Credit Administration is a debt owed the United States within the meaning of §3466."

We submit that that case is not controlling here. Whether or not the agency is or is not a separate entity depends in each case upon the act creating the agency. Throughout its history the Farm Credit Administration was construed to be the *alter ego* of the United States and

possessed of its sovereign privileges, priorities and immunities.

Whereas the Small Business Administration under its act of organization may in its own name, sue and be sued; enter into contracts, including contracts with the United States Government; buy and sell property; join with ordinary commercial lending institutions in making ordinary commercial loans to small business organizations; the Farm Credit Administration was determined not to be a commercial adventure but merely an arm of the Government (*U. S.* v. *Thomas*, 107 F.2d 765), which enjoyed immunity from suit (*Helms* v. *Emergency Crop & Seed Loan Office —Farm Credit Administration*, 216 N.C. 581, 5 S.E.2d 822), and actions on behalf of the Farm Credit Administration should be maintained in the name of the United States (*U. S.* v. *Fontenot*, 33 F. Supp. 629).

While numerous interesting questions were raised in *United States* v. *Emory*, 314 U.S. 423, and priority was accorded to a claim of the Federal Housing Administration in that case, the question here presented was neither raised nor determined by the Court in that case, and it certainly cannot be considered authority for so broad and sweeping a statement as is here made by the petitioner.

In *United States* v. *Marxen*, 307 U.S. 200, 83 L. Ed. 1222, the Court carefully pointed out that this issue was not raised and would not be determined. In that case only a single question was certified to the Court, and the Court said:

> "Although an amendment to the National Housing Act authorized the Administrator to sue and be sued in any Court of competent jurisdiction, State or Federal, it is not necessary in answering the present certificate to determine whether by this addition the Congress intended to give the Administrator the status

of a corporation or other entity distinct from the United States and by such status, to confer on or withhold from claims of the Federal Housing Administration against bankrupts the advantages of §3466. We can deal only with a claim of the Federal Housing Administration, assigned to the United States after the adjudication in bankruptcy of the obligor. It is assumed that such a claim belongs to and is made by the United States."

Since this question was not raised in the *Emory* case, and in view of the express reservation of this question in *Marxen*, neither case can be considered determinative of the issue here. It may even be doubted that the *Emory* case would be authority for a priority for the F.H.A. in a case where this question was in issue.

In the Korman case, the Court of Appeals for the District of Columbia examined the Congressional intent and determined that the Federal Housing Administration is not to be regarded as a separate legal entity from the United States. That case may be authority for claims of the F.H.A.; but not for the proposition that any non-incorporated agency must be regarded as the United States. On the contrary, it indicates that each agency must be considered separately and stand or fall from a consideration of the act creating it and the Congressional intent in connection therewith.

In *Sloan Shipyards Corporation* v. *United States Shipping Board*, 258 U.S. 549, 66 L. Ed. 762, the Court points out the enormous powers ultimately given to the Fleet Corporation and says that they have suggested the argument that it was so far put in place of the sovereign as to share the immunity of the sovereign from suit. The Court then reasons:

"Supposing the powers of the Fleet Corporation to have been given to a single man, we doubt if any

one would contend that the acts of Congress and the delegations of authority from the President left him any less liable than other grantees of the power of eminent domain to be called upon to defend himself in Court. An instrumentality of Government he might be, and for the greatest end; but the agent, because he is agent, does not cease to be answerable for his acts. * * *

"If what we have said is correct, it cannot matter that the agent is a corporation rather than a single man. The meaning of incorporation is that you have a person, and as a person one that presumably is subject to the general rules of law." (567).

The Court therefore held the Fleet Corporation not immune from suit. Concerning its claim for priority in bankruptcy the Court said:

"The claim was presented by the Fleet Corporation in its own name, but was put forward by it as an instrumentality of the Government of the United States. It was denied successively by the referee, the District Court, and the Circuit Court of Appeals, on the ground that the Fleet Corporation was a distinct entity, and that, whatever might be the law as to a direct claim of the United States, the Fleet Corporation stood like other creditors and was not to be preferred. 274 Fed. 893. The considerations that have been stated apply even more obviously to this case." (570).

A recovery in this case will be paid, not to the United States, but to the revolving fund of the S.B.A. While the administration is required to pay into miscellaneous receipts of the Treasury, at the close of each fiscal year, interest on the net amount of cash disbursements from advances, it is not required to make an accounting to the Treasury for its proceeds from individual loans as

such. A debt due to the S.B.A. is not a debt due to the United States.

An examination of the powers granted to the Small Business Administration clearly demonstrates that it was intended to be, and is a separate and distinct entity from the United States, and that debts due to the Small Business Administration are not "debts due to the United States" within the meaning of R.S. §3466.

CONCLUSION.

For all of the reasons hereinbefore set forth, the decisions below were correct and the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES

No. 42.—October Term, 1960.

Small Business Administration, Petitioner, v. G. M. McClellan, Trustee.	On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit.

[December 5, 1960.]

Mr. Justice Black delivered the opinion of the Court.

The Small Business Act of 1953 [1] created the Small Business Administration to "aid, counsel, assist, and protect insofar as is possible the interests of small-business concerns in order to preserve free competitive enterprise . . . and to maintain and strengthen the overall economy of the Nation." [2] The Administration was given extraordinarily broad powers to accomplish these important objectives, including that of lending money to small businesses whenever they could not get necessary loans on reasonable terms from private lenders.[3] When a part, but not all, of a necessary loan can be obtained from a bank or other private lender, the Administration is empowered to join that private lender in making the loan.[4] The basic question this case presents is whether, when the Administration has joined a private bank in a loan and the borrower becomes a bankrupt, the Administration's interest in the unpaid balance of the loan is entitled to the priority provided for "debts due to the United States" in R. S. § 3466 and § 64 of the Bankruptcy Act,[5] even though

[1] 67 Stat. 232, as amended, 15 U. S. C. §§ 631–651.

[2] 67 Stat. 232. [3] 67 Stat. 235–236. [4] *Ibid.*

[5] R. S. § 3466, 31 U. S. C. § 191, establishes a general priority for debts due to the United States. Section 64 of the Bankruptcy Act, as amended, 11 U. S. C. § 104, provides that in bankruptcy cases, the priority so established should come fifth in the order of preferred creditors.

the Administration has agreed to share any money collected on the loan with the private bank.

That question arises out of a joint bank-Administration loan of $20,000 to a small business, $5,000 of the loan having come from the funds of the bank and $15,000 from the Government Treasury. Nine months later, an involuntary petition in bankruptcy was filed against the borrower by other creditors. The Administration appeared in the proceedings upon that petition, filed a claim for $16,355.69, the amount then due on the loan, including interest, and asserted priority for its claim to the extent of $12,266.75, its 75 per cent interest in the debt. After a hearing, the referee in bankruptcy denied priority on the ground that the Administration is a "legal entity" and therefore not entitled to the "privileges and immunities of the United States." The District Court, on review, rejected the ground upon which the referee had relied but concluded that since the bankrupt's note evidencing the loan was not assigned by the bank to the Administration until after the commencement of bankruptcy proceedings, the debt is not entitled to priority.[6] The Court of Appeals affirmed on a third ground—that the Administration, having contracted to pay the participating private bank one-fourth of any distribution received, could not assert its priority and thus permit a private party to benefit from a priority which, under R. S. § 3466 and the Bankruptcy Act, belongs to the Government alone.[7] We granted certiorari to consider the Government's contention that the denial of priority to the Small Business Administration handicaps that agency in the effective performance of the duties imposed upon it by Congress.[8]

First. It is contended that the referee was correct in holding that the Small Business Administration is a sepa-

[6] 168 F. Supp. 483.
[7] 272 F. 2d 143.
[8] 362 U. S. 947.

rate legal entity and therefore not entitled to governmental priority in a bankruptcy proceeding. The contention rests upon a supposed analogy between this case and *Sloan Shipyards Corp.* v. *United States Fleet Corporation*,[9] and *Reconstruction Finance Corp.* v. *Menihan Corp.*,[10] in which cases this Court refused to treat the corporate governmental agencies involved as the United States. Neither of those cases, however, is controlling here. The agency involved in *Sloan Shipyards*, the Fleet Corporation, was organized under the laws of the District of Columbia pursuant to authority of an Act of Congress which "contemplated a corporation in which private persons might be stockholders." [11] This fact alone is enough to distinguish the Fleet Corporation from the Small Business Administration, which, as was contemplated from the beginning, gets all of its money from the Government Treasury. Our decision in the *Reconstruction Finance Corp.* case is equally inapplicable for that case involved only the question of whether the Reconstruction Finance Corporation, having been endowed by Congress with the capacity to sue and be sued, could be assessed costs in connection with a suit it brought. The holding that such costs could be assessed would not support a holding that the Small Business Administration is not the United States for the purpose of bankruptcy priority.[12]

[9] 258 U. S. 549.

[10] 312 U. S. 81.

[11] 258 U. S., at 565.

[12] The proper scope of that holding was recognized by Congress itself when, several years later, the Reconstruction Finance Corporation Act was amended expressly to deny the Corporation a right of priority except with respect to debts arising out of its wartime activities. Act of May 25, 1948, 62 Stat. 261. That the assumption underlying this amendment was that the Corporation would otherwise have had priority for all debts due to it is clear from the discussion of the purpose of the amendment in the Senate. Senator Buck stated that purpose as follows: "The committee believes that RFC should not

Thus neither of these cases requires us to hold that the Small Business Administration, an agency created to lend the money of the United States, is not entitled to all the priority that must be accorded to the United States when the time comes to collect that money. Under like circumstances we refused to deny priority for debts due to the Farm Credit Administration in *United States* v. *Remund*.[12] As was said there, of the Farm Credit Administration, the Small Business Administration is "an integral part of the governmental mechanism" [14] created to accomplish what Congress deemed to be of national importance. And it, like the Farm Credit Administration, is entitled to the priority of the United States in collecting loans made by it out of government funds.

Second. Respondent contends, as the District Court held, that the Small Business Administration's assertion of priority is precluded by our holding in *United States* v. *Marxen* [15] that priority attaches only to those debts owing to the United States on the date of the commencement of bankruptcy proceedings and not to debts that come into existence after that date. But this requirement of the *Marxen* case is fully met here by virtue of the fact that the debt due the Administration arises out of the loan made jointly by the bank and the United States nine months prior to the petition in bankruptcy. Since beneficial ownership of the three-fourths of the debt for which

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have such priority with respect to debts arising from its normal lending activities. A provision has been included in this section *which will eliminate that priority* except with respect to debts arising under the specific war powers which are designated therein." (Emphasis supplied.) Cong. Rec., 80th Cong., 2d Sess., Vol. 94, Part 3, p. 4108. See also *In re Temple*, 174 F. 2d 145.

[13] 330 U. S. 539.

[14] *Id.*, at 542.

[15] 307 U. S. 200.

priority is asserted belonged to the Administration from the date of the loan, it is immaterial that formal assignment of the note evidencing the debt was not made by the bank until after the filing of the petition.

Third. The Court of Appeals held, and the contention is reiterated here, that the Administration forfeited any right it might otherwise have had to priority by agreeing to turn over to the bank one-fourth of any distribution obtained because of its priority. By this arrangement, it is urged, the Administration is attempting "to give priority to a claim which the United States is collecting for the benefit of a private party," contrary to the principles announced by this Court in *Nathanson* v. *Labor Board.*[16] But the *Nathanson* case involved a significantly different situation. There the National Labor Relations Board sought to obtain governmental priority for back-pay claims belonging to employees based upon their loss of pay as a result of allegedly discriminatory discharges by the bankrupt. This Court's denial of priority in that case, involving claims in which the United States had no financial interest, would not justify a denial here where the money was loaned by, and the debt sought to be collected is due to, the United States. The fact that the Administration has contracted to pay the participating private bank one-fourth of any money it later collects on its loan does not mean the Government must lose its priority. Respondent's argument to the contrary seems to rest upon the assumption that the Government is deprived of its priority by making a contract to pay a part of its funds to another creditor of the bankrupt who has no priority. This argument finds no support whatever in § 3466, in § 64 of the Bankruptcy Act, or in the Small Business Act. Section 3466 declares in unequivocal language that the United States is entitled to priority "whenever any

[16] 344 U. S. 25, at 28.

person indebted to the United States is insolvent,[17] and § 64 recognizes that priority in bankruptcy proceedings. The purpose of these sections is simply to protect the interest of the Government in collecting money due to it.[17] Once that money is collected and placed in the Government Treasury, the end sought to be achieved by § 3466 and § 64 of the Bankruptcy Act is completely satisfied. At that point, there is no difference between the money so received and money received from any other source and, like other money, it may be disbursed in any way the Government sees fit, including the satisfaction of obligations already incurred, so long as the purpose is lawful. The Small Business Administration is authorized to enter into contracts calculated to induce private banks to make loans to small businesses.[18] The contract involved in this case, by providing additional security to the private bank at the Government's expense, is well adapted to that end. Indeed, in many cases such a contract may be the only way the Administration could induce private bank participation in a necessary loan. In those cases, acceptance of respondent's argument would make it more difficult for the Administration to perform its statutory duties. Clearly Congress did not intend, by the very act of imposing duties upon the Administration, to take away a privilege necessary to the effective performance of those duties.

Respondent's argument from the policy of equality of distribution for similar creditors expressed in the Bankruptcy Act [19] is no more convincing. It is true that the allowance of the priority asserted here will place the bank, a private unsecured creditor, in a better position than

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[17] For a discussion of the history and purposes of R. S. § 3466, see *United States* v. *State Bank*, 6 Pet. 29, 35–37. Compare *Nathanson* v. *Labor Board*, *supra*, at 27–28.

[18] 67 Stat. 236.

[19] 11 U. S. C. § 1 *et seq.*

other private unsecured creditors. But this position is a result, not of any inequality of distribution on the part of the bankruptcy court, but of the bank's valid contract with the Small Business Administration.

Fourth. Respondent's last contention, urged throughout these proceedings, is that governmental priority is inconsistent with the basic purposes and provisions of the Small Business Act. The contention rests upon the fact that having a creditor with governmental priority tends to make it more difficult for a small businessman to borrow money from other persons, and, in this respect, handicaps rather than aids borrowers, thus conflicting with the Act's basic policy. In *United States* v. *Emory*, we rejected this same argument, with reference to priority for Federal Housing Administration debts, stating that "only the plainest inconsistency would warrant our finding an implied exception to . . . so clear a command as that of § 3466." [20] The same conclusion must be reached here.

It was error for the courts below to refuse the Government's claim for priority.

Reversed and remanded.

MR. JUSTICE DOUGLAS dissents.

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[20] 314 U. S. 423, 433. See also *United States* v. *Remund*, *supra*, at 544-545; *Illinois ex rel. Gordon* v. *United States*, 328 U. S. 8, 11-12.